برنامج تحقيق
التوازن المالي

Fiscal Balance Program

2018 update

VISION 2030 رؤية
المملكة العربية السعودية
KINGDOM OF SAUDI ARABIA


بسم الله الرحمن الرحيم

1. Historical background on the program

The Fiscal Balance Program 2017-2020 that was launched in December 2016 represented a medium-term fiscal planning mechanism to sustain the status of public finances and achieve a balanced budget. The program was based on 5 key pillars:

- Rationalizing Government Expenditures
- Energy and Water Price Reform
- Other Government Revenues
- Household Allowance
- Enabling Private Sector Growth

In 2017, the Fiscal Balance Program was reviewed in light of the economic developments in the Kingdom. The Fiscal Balance Program will be updated and published on an annual basis as an integral part of the annual budget statement.

The overall timeline of the program has been reviewed and the timeline for some reforms has been extended in light of multiple factors. These factors included local and global economic performance during the previous year, the fiscal and economic impacts of some of the implemented initiatives, the expected impact of other planned initiatives, and the medium-term economic growth targets, which represent a major objective of the Vision 2030. The new timeline means that the Kingdom will reach a balanced budget by 2023 instead by 2020, in order to prevent having a negative impact on GDP growth rates.

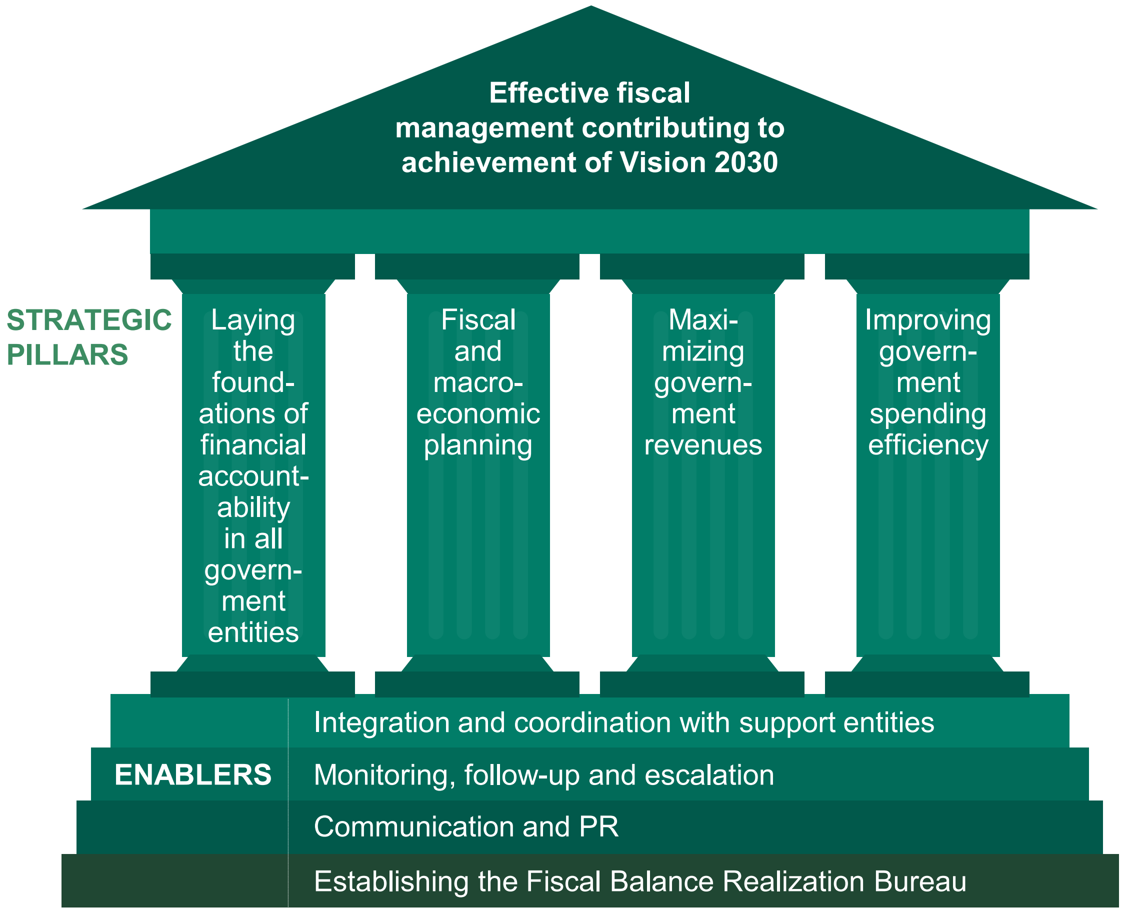
In this update to the Fiscal Balance Program, we are presenting a recap of the new developments and adjustments to policies based on decisions made in 2017.

2. Program Implementation Mechanism

The Fiscal Balance Program has set ambitious goals requiring significant changes in the fiscal policy. Thus, the following four strategic pillars have been identified:

1. Laying the foundations of financial accountability in all government entities by allocating a budget consistent with the strategic priorities of these entities, and establishing a system promoting accountability and full ownership of financial targets across all entities
2. Fiscal and Macroeconomic Planning directing the fiscal policy towards achieving fiscal and economic sustainability and enabling efficient decision-making process for budget management while providing an integrated picture of debts and reserves
3. Maximizing Government Revenues by creating a portfolio of revenue initiatives necessary to achieve the fiscal balance objectives
4. Improving Government Spending Efficiency through optimal utilization of state resources

Strategic pillars that help the Fiscal Balance Program realize key strategic objectives



1. Laying the foundations of financial accountability in all government entities:

The Ministry of Finance has initiated a number of initiatives in order to strengthen accountability, increase fiscal transparency and increase the financial supervision of government entities. This is expected to prevent expenditures from exceeding the budget. This pillar includes two key initiatives:

- Enabling government entities to sustain fiscal balance: This initiative seeks to strengthen performance management mechanisms in order to ensure the entities' compliance with fiscal targets, i.e. budget ceilings and revenue projections. It also aims at monitoring Key Performance Indicators (KPIs) and fiscal targets at the entities' level. Other objectives of this initiative include the supervision of performance management processes, including the provision of incentives and accountability if the fiscal outcomes fail to meet the fiscal targets laid out at the beginning of next year.

- Enhancing the Budgeting Process: The Ministry of Finance has launched a new budgeting methodology in 2018 based on two principles: (1) Distributing the budget from the overall level to the detailed level, (2) and raising the spending efficiency. Workshops have been held with the budget entities in order to discuss the budget and identify their needs. This new methodology will be implemented on an annual basis as part of the future budgeting phases, so that the annual budget is consistent with the Kingdom's fiscal targets. One of the features of the new budgeting methodology is to set spending ceilings from the macro level to the detailed entity level taking into account national and entity priorities. Furthermore, budget review workshops have been held and a new governance system has been implemented. The Ministry of Finance will continue to set priorities, adhere to the spending ceilings of the entities, and work with these entities in order to put an end to some practices that negatively affect spending efficiency.

2. Fiscal and Macroeconomic Planning:

This pillar includes identifying policies to meet fiscal targets while supporting economic objectives by directing government spending to sectors that support the Kingdom's strategic objectives, identifying revenues levers necessary to achieve this objective, and working on support and stimulus initiatives such as the Citizen's Account.

- Medium-Term Fiscal Framework: The aim of this initiative is to establish a clear framework for medium-term expenditure (3-5 years), and to set budget ceilings at the macro and entity levels, setting criteria for entities to follow when creating and introducing their draft budgets, and linking the entities' ceilings to strategic priorities, sector policies and performance assessments.

- Reimbursement of SMEs fees: The objective of the initiative is both to encourage new SMEs to enter the market, and to support them to grow during the first years of operations that are traditionally challenging. This is done by reimbursement of selected fees to start ups in selected priority sectors, (e.g. fees related to new licenses, annual fees, employer related fees) during their first 3 years of operations.

- Indirect SME lending initiative: Indirect lending provides the Government with the ability to leverage the network of commercial non-banking loan providers to distribute loans to targeted SME's by providing them with low cost funds and refinancing. This will improve SMEs access to financing and thus better enable their operations and investments

- SME Financing – Kafalah capital Initiative: A complete revamp and rebuild of Kafalah is being conducted to ensure its sustainability and to continue the successful support of the KSA SME sector.

- Support struggling companies: This program will identify and support struggling companies by providing liquidity or (quasi-) equity financing. Operations (i.e. assessment & provision of financial support) will be outsourced to the private sector (banks, funds), while the approval of the targeted assessment and support will be strictly controlled by the government owners' supervisory committee. The forms of support offered will be debt financing to private sector, equity financing to private sector, consultation and advisory, as well as guarantee of private sector investment IRR.

- Project Support Fund: This effort will establish a fund to grant low interest loans to large projects with significant economic impact in the health, tourism, and real estate sectors to guarantee the continuation and completion of these projects.

- Highly efficient A/Cs: Buyers of new A/C units will receive a subsidy if they choose higher efficiency appliance. Full scale nation-wide implementation will target the purchase of 520,000 A/C units over the next four years and will follow local content requirements.

- Supported housing loans: This will provide a subsidy to facilitate home ownership and help get real-estate financing. This will be done by providing down-payment support ranging from 10% to 20% depending on the income level and household size.

- Export incentive program: This will remove barriers that prevent companies from exporting by providing logistics and legal grants, marketing grants and market information to help companies build up exporting capabilities and discover new markets.

- Export Financing: This will improve export financing capabilities by scaling up existing program and establishing a new EXIM bank in order to provide exporting companies with required financing to access additional markets.

- SME Financing – Government VC fund: This will establish a government Venture Capital fund that will focus on investing in the early and growth stages of the enterprise growth cycle, and thus will target gaps in existing SME funding not covered by current PE/VC fund of fund proposals.

- The Mega Investments Program: This will accelerate investment attraction in KSA by launching the Mega Strategic Investments Program, aiming at negotiating customized deals with local and foreign large investors to implement projects with high social and economic value for the Kingdom.

- Broadband Stimulus Fund: A stimulus fund to accelerate operators' fiber and high speed wireless deployment in urban and rural areas will provide financial incentives of ~40% for the investments of fiber operators.

- Housing technology: The Eskan housing technology and innovation program will unlock the production capacity needed to achieve the national housing target through increasing productivity, which will enable additional GDP increase.

- Private Sector Feedback Platform: This initiative will develop an online feedback platform for continuous communication with the private sector which will increase ability for the private sector to give feedback

- Private Sector Labs: Based on the feedback of the private sector during Private Sector Labs in May 2017, this initiative will institutionalize the Private Sector Labs as an annual platform for direct engagement with the private sector. This will increase the Private sector's visibility on the development roadmap and ongoing initiatives, and on stimulus initiatives.

- Open ministerial panels: This will launch open monthly panels in Chambers of Commerce that are attended by ministers and high government officials and supported by a task force led by MCI with SAGIA, SMEA and LCPSD as members.

- The Citizen's Account: The Citizen's Account Program was created to improve the efficiency of government support and direct support to eligible citizens in order to reduce the impact of the energy price reform and other financial measures on Saudi households. This program will become one of the government's platforms to provide direct support to the citizens.

- Water Price Reform: Water Price Reform is a parallel measure to Energy Price Reform. It aims to (1) Strengthen the fiscal situation, (2) Stimulate rational consumption; and (3) Redirect subsidies in order to deliver it to the most needy segments.

- Energy Price Reform: Energy Price Reform is the most important element of the fiscal balance program. This initiative aims to: (1) Stimulate rational consumption; (2) Encourage the establishment of competitive investments in the industrial sector; (3) Redirect and Rationalize support provided to eligible segments, and (4) Strengthen the general fiscal position. The energy price reform plan has been modified from what was announced in the fiscal balance program in 2016, as described in the following chart. (The plan is subject to modification according to the developments of the Fiscal Balance Program).

Product	2018	2019	2020	2021	2022	2023	2024	2025
Gasoline (Benzene)	Targeted and gradual transition to the linked Reference Price							
Diesel	Targeted and gradual transition to the linked Reference Price							
Aviation Fuel	Linking to the Reference Price*							
Natural Gas and Ethane			Targeted and gradual transition to the linked Reference Price with an applied price ceiling					
LPG and Kerosene (retail sector)		Linking to the Reference Price						
Asphalt		Targeted and gradual transition to the linked Reference Price						
Natural Gas Liquids (incl. Propane, Butane and Natural Gasoline)			Targeted and gradual transition to the linked Reference Price					
Other liquid fuel products (HFO 180, HFO 380, Arabian Light Crude oil, Arabian Heavy Crude Oil)		Targeted and gradual transition to the linked Reference Price						
Electricity Tariff	Reflects production cost based on the price of fuels, assuming ideal efficiency							

* Only for Saudi Arabian Airlines

The prices resulting from the above shall apply generally to energy products used by all sectors throughout the economy with the intent of providing the suppliers of energy products international standards for return on investment while recognizing the Kingdom's comparative advantages in domestic supply of hydrocarbons.

3. Maximizing Government Revenues:

This pillar is based on three key initiatives. Each new revenue source has been developed to ensure the provision of additional public benefits, such as encouraging competition and/or improving social behavior (reducing excessive consumption or the consumption of harmful substances).

- Expat Levy: This key initiative aims to encourage Saudization by bridging the cost gap between expatriates and Saudis. This is achieved by imposing a monthly fee on each expat employee in the private sector based on the number of expatriates compared to the number of Saudi employees within the same enterprise, starting from January 2018, with an annual increase of SR 200 per month (SR 300 per person in an enterprise in which the number of expatriates are equal or less than the number of Saudis, and SR 400 if the number of expatriates exceeds Saudis in 2018). In addition, a fee was imposed on dependents starting from July 2017, with an annual increase amounting to SR 100 to be paid on a monthly basis (100 in the first year, then 200, 300, 400 Riyals in the following years).

- The Value Added Tax: The implementation of the value-added tax is part of the implementation of the GCC Agreement and it is expected to become one of the main sources of non-oil revenues in the Kingdom. This confirms the significance of the proper implementation of this tax, which will start on 1/1/2018, by imposing 5% VAT.

- The Excise Tax: This type of tax achieves a double objective represented in (1) the development of non-oil revenues and (2) the promotion of sensible consumption of certain commodities, such as soft drinks, energy drinks, and tobacco and its derivatives. This may include other products such as luxury goods.

4. Improving government spending efficiency

This pillar aims to increase the efficiency of spending through the following key initiatives:

- Establishing a Spending Efficiency Realization Center: This center will oversee and support other entities in developing their initiatives in order to increase their spending efficiency, remove implementation-related obstacles and propose the necessary legislation and regulations to ensure the sustainability of spending efficiency.

- Establishing a Strategic Procurement Unit: this will aim to transform government procurement into a strategic process focused on optimizing financial and developmental benefits to government spending, and enhancing transparency through the development of capacity, systems and procurement operations. This will help measure and optimize procurement by implementing the best local and global practices for each spending category.

These two key initiatives aim at activating other initiatives and programs whose cumulative savings are estimated at approximately SR 220 billion (+/- 15%) by the end of 2023. Government entities have been able to support the CAPEX and OPEX Rationalization Office in terms of activating the first package of initiatives during 2017 and achieved savings up to SAR 56 billion, which will have a cumulative effect until 2023, by avoiding additional operational costs of approximately 57 billion. In addition, by establishing the Spending Efficiency Realization Center and the Strategic Procurement Unit in 2018, the Fiscal Balance Program seeks to support government entities by activating the second package of priority initiatives in order to achieve spending efficiency.

3. Program Governance to Ensure the Efficient Implement-ation

The Fiscal Balance Office was established in 2017, it aims to achieve the program objectives by monitoring the initiatives' implementation, following-up, evaluating their readiness, and creating new initiatives in order to achieve the program objectives. A committee composed of representatives from different entities will oversee the execution of the program and will lead it to achieve its objectives. The committee of the Fiscal Balance Program assumes the following key roles:

- Approving the executive plans of the Fiscal Balance Program.
- Ensuring consensus among the various key stakeholders.
- Providing strategic input to the Fiscal Balance Program statements, scenarios, courses, and initiatives related to it.

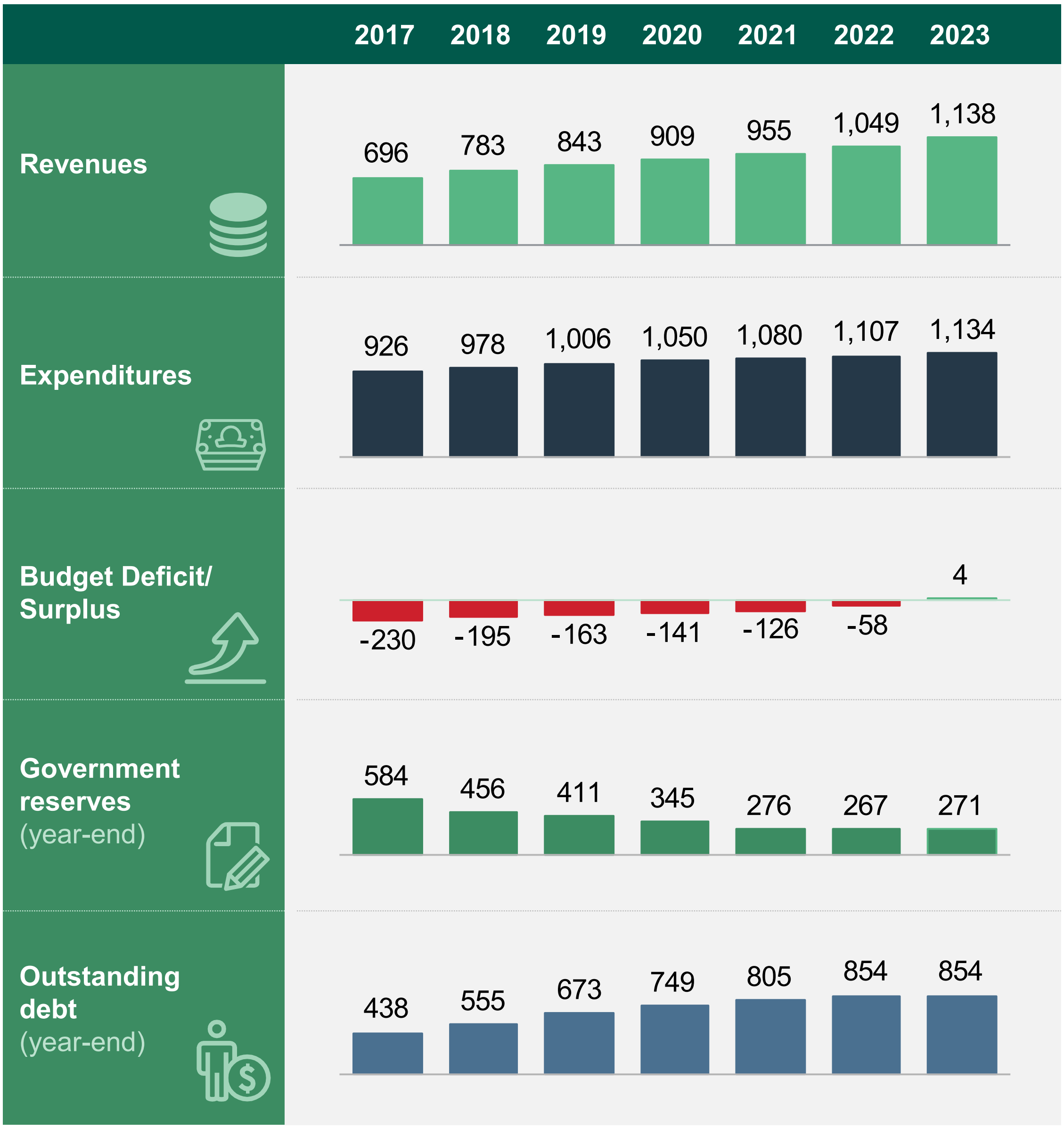
The committee is governed by the following two entities in the Royal Court, who are responsible for the decision-making process: The Financial Committee (in charge of setting the financial objectives), the Strategic Committee (in charge of setting national economic priorities and monitoring the execution of the programs of the Vision 2030).

4. Program Medium-Term Fiscal Outlook to achieve Fiscal Balance

According to the fiscal and economic framework, based on which the budget and initiatives of the Fiscal Balance Program were prepared, the budget deficit in 2018 is expected to reach SAR 195 billion equivalent to 7.3% of GDP, decreasing by 1.6 percentage points of GDP below the estimated deficit for 2017 and decreasing greatly below the 2016 deficit which was 12.8% of GDP. This decline in the deficit projected for 2018 budget is due to the rise in total revenues by 12.6% over 2017 estimates due to the reform measures to increase non-oil revenues and diversify their sources. This reduction in the deficit will happen despite an increase in spending of 5.6%, including an increase in non-financial assets (capital expenditure) by 13.6% compared to 2017 estimates.

Mid-term public finance estimates (2017-2023)

SAR bn unless stated otherwise



Sums may be inaccurate due to rounding

A. Revenues

Since 2016, a number of reform measures have been implemented, which will influence the growth of revenues over the medium term, as well as the plan of implementing several other measures in the coming years, which will gradually diversify revenues sources. These measures include the introduction of value-added tax and expat levies and the energy price reform to be aligned with reference energy prices. Additionally, the government aims for the structural and continuous development of revenues to be the primary source to finance government spending and reduce budget deficit.

Estimates indicate that total revenues will reach SAR 783 billion in 2018, increasing by 12.6% over 2017 budget estimates, and expected to reach SAR 909 billion in 2020 with an average annual growth of 9.3%. In addition, total taxes are expected to reach SAR 142 billion at a growth rate of 46% in 2018 compared to 2017, reaching SAR 189 billion in 2020. Taxes on income, profit and capital gains are estimated to collect SAR 15 billion in 2018 at a growth rate of 10.4% compared to 2017, reaching SAR 18 billion in 2020 given prospective economic growth rates over the coming period. Meanwhile, taxes on goods and services are estimated at SAR 85 billion, rising by 82% over 2017 to SAR 124 billion in 2020. This comes as a result of implementing some economic reforms, such as value-added tax, which are projected to generate revenues of SAR 23 billion in 2018. Revenues from excise tax are expected to generate SAR 9 billion in 2018, while expat levies revenues are projected to reach to SAR 28 billion.

Taxes on international trade and transactions are projected to reach SAR 25 billion with growth rate of 17% in 2018 compared to 2017, reaching SAR 28 billion by 2020. This growth is attributed to the implementation of certain reforms related to customs revenues, such as the re-imposition of customs duties on 193 goods and the implementation of post-clearance auditing. Other taxes including Zakat are projected to record SAR 17 billion in 2018 increasing by 10.8% over 2017, reaching SAR 20 billion by 2020.

Other revenues including oil revenues, are estimated at SAR 641 billion with a growth rate of 7% in 2018 compared to 2017, reaching SAR 720 billion in 2020. Additionally, estimates indicate that oil revenues, including the fiscal impact of energy price reform, will reach to SAR 492 billion in 2018 compared to SAR 440 billion in 2017, increasing by 11.8%. It is worth mentioning that the energy price reform plan has been revised so as to carry out implementation gradually at a slower pace, taking into consideration the importance of driving economic activity at higher rates.

B. Expenditures

2018 fiscal year's budget aims to establish a clear medium-term fiscal framework in line with the strategic objectives of the Saudi Vision 2030 Programs and to set spending levels based on a policy that strikes balance between the objective of cutting budget deficit so that public debt levels does not exceed 30% of nominal GDP and the objective of reinforcing economic activity by directing government spending in a manner that supports the economic vision and targeted strategic plans. Government spending, which is considered to be one of the main drivers of the economy, accounts for 36% of nominal

GDP in 2017. Therefore, a budget with total expenditure of SAR 978 billion is approved, rising by 5.6% compared to 2017. This increase is due to the expanded spending on the initiatives of Vision 2030 programs.

1. Operational Expenditures

The medium-term fiscal policy aims to prioritize initiatives that have social and economic returns with respect to operational expenses, such as private sector stimulus packages, Citizen Account Program, and Saudi Vision 2030 Realization Programs. Total operational expenses estimate for 2018 are SAR 773 billion or 79% of total spending, rising by 3.6% compared to 2017. Compensation of employee's estimates are SAR 438 billion, which make up 44.8% of the total expenditure, approximately equal to the actual levels of the current year. In addition, ratios of 'Use of Goods and Services' and 'Social Benefits' to total expenses have constituted 14.6% and 6.7%, respectively, as the spending envelope for Use of Goods and Services rises by 6%. However, spending on subsidies is projected to rise by 102% to SAR 14 billion as a result of executing some programs, such as the stimulus packages that aims to support the privet sector and to enhance its participation, in addition to the industrial sector support program. Further, Social Benefits expenses are expected to rise by 48.1%, motivated by the Citizen Account Program which could reach SAR 32.4 billion in 2018. Financing Expenses are estimated to rise by 57.1% compared to 2017, led by the increase of prospective security issuances to finance the budget.

As shown in the table above, the average growth of operational expenses during the period 2018-2020 stands at 3.3%, driven by increased Social Benefits spending in the medium-term due to the persistent increases in spending on the Citizen Account Program and the growth of spending on financing costs resulting from rises in the volume of issuances, with lower growth rates for the remaining operational.

2. Capital Expenditures

Saudi Arabia's medium-term fiscal policy mainly aims to develop capital expenditure, infrastructure, and the programs of Vision 2030 to provide impetus for economic growth. Additionally, 2018 estimates indicate that capital expenditure will reach SAR 205 billion or 21% of total expenditures, rising by 13.6% compared to 2017, in order to finance the projects of Vision 2030 programs and develop the infrastructure to spur economic growth and generate more jobs for citizens.

The capital expenditure ratio to total government expenditure is projected to increase from 19% in 2017 to 22% in 2020. While total government expenditure growth is expected to average 4.3% for the period 2018-2020, the growth of capital expenditure over the medium term is expected to average 8.3%, in order to drive economic activity and generate job opportunities.

C. Public Debt and Funding

The Ministry, through the Debt Management Office and with the approval of the Finance Committee at the Royal Court, has put in place a medium-term strategy and an annual borrowing plan for the management of public debt. The strategy observes, in the process of borrowing and issuance of debt instruments, the best opportunities available in domestic and international markets. In addition, the strategy aims to avoid the issuance of domestic finance instruments causing any adverse impacts on the liquidity of the domestic financial sector, economic growth rates, and Vision 2030's objective to promote growth of the private sector. It also studies different options available in international markets and analyzes targeted markets, currencies, and future interest rates to minimize the costs of financing the portfolio. Moreover, the public debt management strategy will involve loans and diversification of debt issuances to include Sukuk and bonds with short-, medium-, and long-term maturities.

The Saudi Vision 2030 encompasses numerous initiatives, programs, and sectoral development plans that would bring about a quantum leap in economic performance, during which non-oil GDP growth rates are projected to rise gradually over the medium term. Pursuant to government plans for the Fiscal Balance Program to be implemented more gradually, it is projected that the budget deficit will continue diminishing gradually over the medium term, ultimately accomplishing fiscal balance by 2023. Such reforms contribute to the growth of total revenues with an annual average of 8.6%, along with a rise in expenditures averaging an annual growth rate of 3.4% in the medium term while carrying on plans of increasing the efficiency of spending.